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BEFORE THE ARIZONA CORPORATION COMMISSION

ARIZONA CORPORATION COMMISSION DOCKET CONTROL

2017 APR -3 P 4: 57

COMMISSIONERS

TOM FORESE– Chairman
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DOUG LITTLE
ANDY TOBIN
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Arizona Corporation Commission
DOCKETED
APR 3 2017
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IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN.	DOCKET NO. E-01345A-16-0036
IN THE MATTER OF FUEL AND PURCHASED POWER PROCUREMENT AUDITS FOR ARIZONA PUBLIC SERVICE COMPANY.	DOCKET NO. E-01345A-16-0123

STAFF'S NOTICE OF FILING DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT AGREEMENT

The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission") hereby files the Direct Testimony of Ralph C. Smith and Elijah O. Abinah in Support of the Settlement Agreement, in the above-captioned Dockets.

RESPECTFULLY SUBMITTED this 3rd day of April, 2017.

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CERTIFICATE OF SERVICE

On this 3rd day of April, 2017, the foregoing document was filed with Docket Control as a Utilities Division Pre-Filed Testimony, and copies of the foregoing were mailed on behalf of the Utilities Division to the following who have not consented to email service. On this date or as soon as possible thereafter, the Commission's eDocket program will automatically email a link to the foregoing to the following who have consented to email service.

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BEFORE THE ARIZONA CORPORATION COMMISSION

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Chairman
BOB BURNS
Commissioner
DOUG LITTLE
Commissioner
ANDY TOBIN
Commissioner
BOYD DUNN
Commissioner

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, AND TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN	DOCKET NO. E-01345A-16-0036
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TESTIMONY

IN SUPPORT OF

THE SETTLEMENT AGREEMENT

OF

ELIJAH O. ABINAH

ACTING DIRECTOR

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

APRIL 3, 2017

TABLE OF CONTENTS

EXECUTIVE SUMMARY
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NOS. E-01345A-16-0036 & E-01345A-16-0123

Mr. Abinah's testimony supports the adoption of the Settlement Agreement ("Agreement") as proposed by the Signatories in this case. This testimony describes the settlement process as open, candid, transparent and inclusive of all parties to this case. Mr. Abinah explains why Staff believes this Agreement is in the public interest.

Mr. Abinah's testimony recommends that the Commission adopt the Agreement as proposed.

SECTION I - INTRODUCTION

Q. Please state your name, occupation, and business address.

A. My name is Elijah O. Abinah. I am the Acting Director employed by the Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. Briefly describe your responsibilities as the Acting Director.

A. As an Acting Director, I manage the day-to-day operations of the Utilities Division with the assistance of the Utilities Division Assistant Director and oversee the management of the Division. In addition, I am responsible for making policy and technical decisions for the Division.

Q. Please state your educational background and pertinent work experience.

A. I received a Bachelor of Science degree in Accounting from the University of Central Oklahoma in Edmond, Oklahoma. I also received a Master of Management degree from Southern Nazarene University in Bethany, Oklahoma. Prior to my employment with the ACC, I was employed by the Oklahoma Corporation Commission for approximately eight and a half years in various capacities in the Telecommunications Division.

Q. What is the purpose of your testimony in this case?

A. The purpose of my testimony is to support the Proposed Settlement Agreement ("Agreement"). I will also provide testimony which addresses the settlement process, public interest benefits and general policy considerations.

Q. Did you participate in the negotiations that led to the execution of the Agreement?

A. Yes, I did.

Q. How is your testimony being presented?

A. My testimony is organized into five sections. Section I is this introduction, Section II provides discussion of the settlement process, Section III discusses the various parts of the Agreement, Section IV identifies and discusses the reasons why the Agreement is in the public interest and Section V addresses general policy considerations.

Q. Will there be other Staff witnesses providing testimony in this case?

A. Yes. Mr. Ralph Smith will be providing testimony to explain the more technical aspects of certain issues addressed in the Agreement including but not limited to depreciation, the various adjustors and transfers of items from adjustors to base rates, rate treatment of the installation of selective catalytic converters at Four Corners, the various cost deferrals addressed by the Agreement, Commercial and Industrial rate design, the E-32L rate design, and revenue spread. In addition, all Staff witnesses that filed Direct Testimony prior to the Agreement will be available if the Commission has questions for them.

SECTION II – SETTLEMENT PROCESS

Q. Please discuss the settlement process.

A. The settlement process was open, transparent and inclusive. All parties received notice of the settlement meetings and were accorded an opportunity to raise, discuss, and propose resolution to any issue that they desired.

Q. Over what period did the Settlement meetings take place?

A. Large group Settlement meetings relating to revenue requirement and rate design, began in January 2017 and continued until the Settlement Agreement was filed on March 27, 2017. In addition, there were numerous other discussions involving individual parties and/or groups.

Q. Who participated in those meetings?

A. The following parties were participants in some or all of the meetings: Arizona Public Service Company ("APS" or "Company"), Richard Gayer; Warren Woodward; Arizona Solar Deployment Alliance ("ASDA"); IO Data Centers, LLC ("IO"); Freeport Minerals Corporation ("Freeport") and Arizonans for Electric Choice and Competition (collectively, "AECC"); Sun City Home Owners Association ("Sun City HOA"); Western Resource Advocates ("WRA"); Arizona Investment Council ("AIC"); Arizona Utility Ratepayer Alliance ("AURA"), Property Owners and Residents Association, Sun City West ("PORA"); Arizona Solar Energy Industries Association ("AriSEIA"); Arizona School Boards Association ("ASBA") and Arizona Association of School Business Officials ("AASBO") (collectively, "ASBA/AASBO"); Cynthia Zwick, Arizona Community Action Association ("ACAA"); Southwest Energy Efficiency Project ("SWEEP"); the Residential Utility Consumer Office ("RUCO"); Vote Solar; Electrical District Number Eight and McMullen Valley Water Conservation & Drainage District (collectively, "ED8/McMullen"); The Kroger Co. ("Kroger"); Tucson Electric Power Company ("TEP"); Pima County; Solar Energy Industries Association ("SEIA"); the Energy Freedom Coalition of America ("EFCA"); Wal-Mart Stores, Inc. and Sam's West, Inc. (collectively, "Wal-Mart"); Local Unions 387 and 769 of the International Brotherhood of Electrical Workers, AFL-CIO (collectively, "the IBEW Locals"); Noble Americas Energy Solutions LLC ("Noble Solutions"); the Arizona Competitive Power Alliance ("the Alliance"); Electrical District Number Six, Pinal County, Arizona ("ED 6"); Electrical District Number Seven of the County of Maricopa, State of Arizona ("ED 7"); Aguila Irrigation District ("AID"); Tonopah Irrigation District ("TID"); Harquahala Valley Power District ("HVPD"); and Maricopa County Municipal Water Conservation District Number One ("MWD") (collectively, "Districts"); the Federal Executive Agencies ("FEA"); Constellation New Energy, Inc. ("CNE"); Direct Energy, Inc. ("Direct Energy"); AARP; the City of Coolidge ("Coolidge"); the City of Sedona ("Sedona");

REP America d/b/a ConservAmerica ("ConservAmerica"); and Granite Creek Power & Gas and Granite Creek Farms LLC (collectively, "Granite Creek") and Staff.

Q. Could you identify some of the diverse interests that were involved in this process?

A. Yes. The diverse interests included Staff, RUCO, APS, a shareholders association, consumer representatives including AURA, AARP, demand-side management ("DSM")/energy efficiency advocates, low-income consumer advocates, renewable energy advocates, labor unions, large/industrial users, competitive power producers, an association representing consumers in favor of electric choice and competition, individual residential consumers, and the mines.

Q. How many of these parties executed the Agreement?

A. The Agreement was signed by all participants with the exception of AARP, the Districts, SWEEP, TEP, Pima County, City of Sedona, Mr. Warren Woodward, Ms. Patricia Ferre, and Mr. Richard Gayer. Although some of the parties were not signatories to the Agreement, some of those parties have indicated they have no opposition to the Agreement while others indicated will likely oppose the Agreement.

Q. Was there an opportunity for all issues to be discussed and considered?

A. Yes, each party had the opportunity to raise and have its issues considered multiple times during the course of the negotiations. All parties received notice of the settlement meetings and were invited to participate.

Q. Were the Signatories able to resolve all issues?

A. The Signing Parties were able to resolve and reach agreement on all issues except issues related to the non-ratchet rate design alternative for Commercial and Industrial customers.

The Agreement provides that interested parties may submit their positions on this issue during the evidentiary hearing to be addressed by the Commission in its Order on this matter.

Q. How would you describe the negotiations?

A. I believe that all participants zealously advocated and represented their interests. I would characterize the discussions as candid but professional. While acknowledging that not all parties executed the Agreement, I must re-emphasize that all parties had multiple opportunities to be heard and to have their issues fairly considered. Most intervenors expressed their views on several occasions for consideration by all parties.

Q. Would you describe the process as requiring give and take?

A. Yes, I would. As a result of the varied interests represented in the settlement process, a willingness to compromise was necessary. As evidenced in the Agreement, the Signing Parties compromised on what could be described as vastly different litigation positions.

Q. Because of such compromising, do you believe the public interest was compromised?

A. No. As I will discuss later in this testimony, I believe that the compromises made by the Signatories further the public interest.

Q. Mr. Abinah, you have indicated that the Agreement incorporates diverse interests including those of low-income customers, residential customers, large commercial/industrial customers, energy efficiency advocates, renewable energy advocates, the Company and the investment community. Please discuss how the Agreement addresses the diverse interests of these entities.

A. In the Agreement, there are specific provisions which address many of the concerns expressed by the various interests. For example, the low income customer issues are addressed in Section XXIX. Another example is Section XIX, which addresses residential rate availability. Section XVIII addresses residential rate design for distributed generation customers. Section XXVIII of the Settlement Agreement addresses APS's utility-owned solar AZ Sun II pilot. Section VI addresses depreciation/amortization and decommissioning costs. Section XVI addresses a new tax expense adjustor mechanism ("TEAM") in the event there is significant Federal income tax reform legislation. Section XXIV addresses military customers taking service under rates E-34 and E-35. Section XXX deals with the AMI Opt-Out program, and Section XXXII addresses issues pertinent to the Lost Fixed Cost Recovery Mechanism ("LFCR").

Q. What is the revenue increase and cost of equity requested by the Company?

A. APS requested a net increase in base rates of $165.9 million, which included a requested cost of equity of 10.5 percent.[1]

Q. What is the revenue increase and cost of equity recommended by the settling parties?

A. The settling parties recommend an overall $87.25 million, non-fuel, non-depreciation revenue requirement increase, which includes a 10.0 percent cost of equity.[2]

SECTION III – SETTLEMENT AGREEMENT

Q. Please describe Part I of the Agreement.

A. Part 1 is a general description of the settlement process and the Agreement itself, which also includes a brief description about why the terms of the Settlement Agreement are just, reasonable, fair and in the public interest.

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[1] See, e.g., APS' Application filed June 1, 2016.

[2] See, e.g., the Proposed Settlement Agreement filed March 27, 2017.

Q. Please describe Part II of the Agreement.

A. In Part II of the Agreement, APS agrees not to file its next general rate case prior to June 1, 2019 using a test year of no earlier than December 31, 2018. This provision of the Agreement is to ensure rate stability for APS's customers while providing adequate revenue to the Company that is fair, just and reasonable and that will allow APS to provide safe and reliable electric services.

Q. Please describe Part III of the Agreement.

A. This section of the Agreement addresses the base rate increase to APS's customers. The Signatories agreed that APS should receive a base rate increase of $94.624 million, exclusive of adjustors ("revenue requirement") or an $87.25 million non-fuel, non-depreciation revenue requirement increase. This is comprised of (1) a reduction of base fuel of $53.63 million; (2) and increase in depreciation of $61.00 million.

Q. Please discuss Part IV of the Agreement.

A. When new rates become effective, customers will have, on average, a 3.28 percent bill impact. Residential customers will have on average a 4.54 percent bill impact, and general service customers will have on average a 1.93 percent bill impact. To mitigate the first year bill impacts, APS will refund to customers through its Demand Side Management Adjustor Charge ("DSMAC") $15 million in collected, but unspent DSMAC funds.

Q. Please describe Part V of the Agreement.

A. The parties agreed upon the following with respect to capital structure, return on equity and embedded cost of debt and the fair value rate of return:

1) A capital structure comprised of 44.2 percent debt and 55.8 percent common equity;

2) A return on common equity of 10.0 percent and an embedded cost of debt of 5.13 percent;

3) A fair value rate of return of 5.59 percent, which includes a return on the fair value increment of 0.8 percent.

Q. Please describe Part VI of the Agreement.

A. This section deals with depreciation and nuclear decommissioning. APS agrees to lower its proposed annual depreciation expense pro forma on its as filed SFR C-2 by $20 million per year, resulting in a $61 million increase in depreciation expense, by adjusting its proposed lives/net salvage rates for distribution accounts and by accelerating the amortization of the present excess depreciation reserves for Palo Verde. The annual depreciation expense for Palo Verde will be decreased by $21 million.

Q. Please describe Part VII of the Agreement.

A. Part VII addresses the Power Supply Adjustor ("PSA"). The Signing Parties agree that the base fuel rate shall be lowered from $0.032071 per kWh, as set in Commission Decision No. 73183 (May 24, 2012), to $0.030168 per kWh.[3] This change shall take effect on the effective date of the new rates contained in this Agreement, in accordance with the current approved Plan of Administration for the PSA.

The Signing Parties further agree that, for purposes of this case that APS shall be permitted to include chemical costs for lime, ammonia and sulfur that are incurred in the generation process in the PSA.

[3] The total base PSA cost will be $0.030667 per kWh, including chemical costs and net margins on the sale of emission allowance.

APS shall be permitted to include third-party storage expenses in the PSA provided that APS files for approval to include any third-party storage contract with the Commission 90 days before it becomes effective.

The September 30 Preliminary Annual PSA Rate filing and the December 31 Final Annual PSA Rate calculation filing will be consolidated into one annual reset filing that will occur annually on or before November 30.

Q. Please describe Part VIII of the Agreement.

A. This section of the Settlement Agreement addresses the transfer of items from adjustment mechanisms to base rates. The Signing Parties agree that certain revenue requirements collected through the Renewable Energy Adjustor Clause, DSMAC, LFCR Adjustor, Transmission Cost Adjustor ("TCA"), Environmental Impact Surcharge ("EIS"), Four Corners Rate Rider ("FCRR"), and the System Benefits Charge ("SBC") adjustment shall be transferred to base rates and those adjustor rates will be zeroed out or reduced.

Q. Please describe Part IX of the Agreement.

A. This section of the Agreement addresses the rate treatment related to the installation of selective catalytic reductions at Four Corners for units 4 and 5. The Signing Parties agree that this docket shall remain open for the purpose of allowing APS to file a request that its rates be adjusted to reflect the addition of Selective Catalytic Reduction ("SCR") equipment at Four Corners, and authorizes APS to defer certain costs for possible later recovery through rates.

Q. Please describe Part X of the Agreement.

A. This section of the Settlement Agreement addresses the Signing Parties' agreement to authorize APS to defer for possible future recovery certain costs related to the Ocotillo Modernization Project.

Q. Please describe Part XI of the Agreement.

A. In this section, the Signing Parties agree APS shall be allowed to defer for future recovery (or credit to customers) the Arizona property tax expense above or below the test year caused by changes to the applicable Arizona composite property tax rate. The deferral will not accrue interest during the deferral period unless it is negative, in which case it will accrue interest in favor of APS's customers at APS's short-term debt rate.

Q. Please describe Part XII of the Agreement.

A. This section of the Agreement addresses APS's cost of service study and requires that APS, in its next rate case, make available to parties its cost of service study in an Excel spreadsheet, and that APS meet and confer with stakeholders prior to filing to discuss the format. Further, APS agrees to perform the Average and Excess methodology to allocate production demand costs to residential and general service classes and then reallocate production demand within the residential sub-classes based on 4CP. APS and other stakeholders are not precluded from proposing alternative allocation methods.

Q. Please describe Part XIII of the Agreement.

A. Part XIII of the Agreement provides that APS will address any potential impacts of the closure of the Navajo Generating Station prior to the filing of its next rate case.

Q. Please describe Part XIV of the Agreement.

A. Part XIV of the Agreement requires that APS file a workforce planning report with the Commission that addresses specific issues such as (i) the identification of each of the specific challenges or issues APS faces regarding workforce planning; (ii) the specific action(s) APS is taking to address each challenge or issue; and (iii) an update of the progress APS has made toward resolving each challenge or issue. The Agreement requires that APS file the report annually, in this docket, on or before May 31 and that it address limited job classifications and minimum criteria that the report shall address. It is intended that this new report will supersede any current workforce filing requirements.

Q. Please describe Part XV of the Agreement.

A. This section of the Agreement addresses a self-build moratorium. APS agrees that it will not pursue any new self-build generation option having an in-service date prior to January 1, 2022, unless expressly authorized by the Commission, and that it will not pursue the construction of combined cycle generation units with an in-service date prior to December 31, 2027. The agreement sets forth limited exceptions.

Q. Please describe Part XVI of the Agreement.

A. This section of the Agreement provides for the TEAM adjustor that, in the event significant Federal income tax reform legislation is enacted and becomes effective prior to the conclusion of APS's next rate case, and that legislation materially impacts APS's annual revenue requirement, the TEAM will enable a pass-through of income tax effects to customers.

Q. Please describe Part XVII of the Agreement.

A. This section of the Agreement describes the Company's proposed residential rate design. The Signing Parties agree to the establishment of seven new residential rate schedules including:

- R-XS for customers without distributed generation using 600 or less kWh per month on average.
- R-Basic for customers without distributed generation using more than 600 kWh but less than 1,000 kWh.
- R-Basic Large for customers without distributed generation using 1,000 kWh per month or more on average.
- TOU-E is a time-of-use schedule available to all customers.
- R-2 and R-3 are three-part demand rates available to all customers.
- R-Tech is an optional R-Tech Pilot Program that will initially serve up to 10,000 customers and complements the use of demand reducing technologies.

The on-peak period will be 3:00 pm - 8:00 pm weekdays for the TOU-E, R-2, R-3 and R-Tech excluding holidays.

Q. Can you please describe the R-Tech Rate in more detail?

A. Yes. This rate schedule is available to residential customers when the following criteria are met: 1) two or more qualifying primary on site technologies were purchased within 90 days of the customer enrolling in the rate; or 2) one qualifying primary on-site technology was purchased within 90 days of the customer enrolling in the rate and two or more qualifying secondary on-site technologies. The primary technologies include a) a rooftop solar photovoltaic system; 2) a chemical storage system; or c) an electric vehicle. The secondary technologies include 1) a device with a variable speed motor; b) a grid-interactive water heating system; c) a smart thermostat; or d) an automated load controller. The R-Tech pilot program will test the ability and desire of participating residential customers to reduce On-Peak energy and demand usage through multiple behind-the-meter technologies.

Q. Please describe Part XVIII of the Agreement.

A. This section of the Agreement addresses the available rate designs for distributed generation ("DG") customers, and establishes that DG customers are eligible for four different schedules including the TOU and Demand rates. In this section the Signing Parties agree to the Resource Comparison Proxy Rate and appropriate grandfathered date for those customers that will continue to take service under existing net metering.

Q. Please describe Part XIX of the Agreement.

A. This section of the Agreement discusses residential rate availability and indicates that all residential customers may select R-Basic, R-Basic Large, TOU-E, R-2, R-3, R-Tech or R-XS if they qualify until May 1, 2018, unless they are grandfathered under their existing rate design. The Signing Parties agree that after May 1, 2018, R-Basic Large will no longer be available and that new customers after May 1, 2018, may choose from TOU-E, R-2, R-3 or if the qualify R-XS or R-Tech. After 90 days, new customers may opt out of their current rate design and select R-Basic if they qualify.

Q. Please describe Part XX of the Agreement.

A. This section of the Agreement addresses the creation of a General Service XS non-demand rate, an Economic Development Service, and the continuation of net metering for commercial and industrial customers.

Q. Please describe Part XXI of the Agreement.

A. In this section APS agrees to redesign E-32L in a revenue neutral manner to recover an additional $1.36 per kW in unbundled generation charges.

Q. Please describe Part XXII of the Agreement.

A. This section of the Agreement establishes that all public schools and public school districts will be eligible for a new rate rider that creates a discount of $0.0024/kWh.

Q. Please describe Part XXIII of the Agreement.

A. This section of the Agreement establishes a new buy-through rate called AG-X. The capacity charge for this rate and other parameters will be re-evaluated in APS's next rate case, including whether AG-X should be evaluated as a separate customer class in the cost of service study. This section also establishes that the deferral for the existing AG-1 rate will be recovered over 5 years from all non-residential customer classes, except the street and area lighting customer classes, using adjusted test year kWh. Further, APS agrees not to propose a deferral of unmitigated costs resulting from AG-X if any.

Q. Please describe Part XXIV of the Agreement.

A. This section of the Agreement establishes that the unbundled delivery charge for service at military-primary voltage under rates E-34 and E-35 will be reduced to a level that results in any applicable military customer getting a net impact bill increase equal to the average for all retail customers.

Q. Please describe Part XXV of the Agreement.

A. In this section APS agrees it will keep the same revenue spread between Residential and General Service classes, but that within General Service, the reduction will be spread to all other GS customers proportionally to the original spread.

Q. Please describe Part XXVI of the Agreement.

A. This section of the Agreement proposes the effective date of the rate plans and establishes a transition plan from APS's existing rate structures to the new rate schedules established in this Agreement. It indicates that customers that do not select a different rate will transition to the updated rate plan most like their existing rate on or before May 1, 2018. It also provides for a report to the Commission by APS indicated how many customers have not made a selection of a new rate.

Q. Please describe Part XXVII of the Agreement.

A. In this section APS agreed to make a one-time allocation of $5 million from over-collected DSMAC funds to DSM programs for education and to help customers manage new rates and rate options. This includes APS filing an outreach and education plan with an opportunity for stakeholders to review and comment on the plan prior to APS completing the final plan.

Q. Please describe Part XXVIII of the Agreement.

A. This section of the Agreement provides for the implementation of new utility-owned distributed generation with the purpose of expanding access to rooftop solar for low and moderate income Arizonans. APS will use third-party solar contractors that are selected through a competitive RFP process. The program will be for not less than $10 million per year and not more that $15 million per year and will be available throughout APS's service area, including rural Arizona. The program is approved for a period of three years from and after the date APS files a notice of the program commencement, and participating customers will receive a bill credit of $10-50 per month applied to their bill.

Q. Please describe Part XXIX of the Agreement.

A. This section of the Agreement addresses limited income programs and provides for the revision of the E-3 Energy Support Program to provide for a flat 25 percent flat bill discount to eligible customers. The E-4 Medical Support Program for limited income customers who have life sustaining medical equipment will be revised to provide a flat 35 percent bill discount for eligible customers. Further APS agrees to fund $1.25 million annually the crisis bill program to assist customers with income less than or equal to 200 percent of the Federal Poverty Guidelines.

Q. Please describe Part XXX of the Agreement.

A. This section of the Agreement approves the AMI Opt-Out program with an up-front fee of $50 to change out a standard meter for a non-standard meter and a monthly fee of $5.

Q. Please describe Part XXXI of the Agreement.

A. In this section APS agrees to create a new classification in Schedule 3 for Rural Business Development which means a tract of land that has been divided into contiguous lots, is owned and developed by a Rural Municipality and where the Rural Municipality will be the lease-holder for future, permanent lessee applicants.

Q. Please describe Part XXXII of the Agreement.

A. This section of the Agreement modifies the LFCR by eliminating the opt-out option approved in Decision No. 73183, changing the adjustment so it is applied as a demand charge per kW for customers with a demand rate and as a kWh charge for customers with a two part rate without demand.

Q. Please describe Part XXXIII of the Agreement.

A. This section of the Agreement authorizes APS to create a balancing account for its Transmission Cost Adjustment Mechanism ("TCA").

Q. Please describe Part XXXV of the Agreement.

A. This section provides that upon the final approval of the Agreement by way of a final non-appealable Commission Order that includes no material changes to the Agreement, all signing parties will promptly withdraw any challenge to Decision Nos. 75859 (January 3, 2017) and 75932 (January 13, 2017) they have filed and further refrain from pursuing any legal challenge to those Decisions. Further the Signing Parties agree to take all steps necessary to stay any and all appeals until such time as the Commission issues its final Order regarding the Agreement.

Q. Please describe Part XXXVI of the Agreement.

A. This section resolves the processing of Staff's audit of the Company's Power Supply Adjustor and acknowledges that any issues relating to the audit report will be addressed in the hearing on the Agreement.

Q. Please describe Part XXXVII of the Agreement.

A. This section provides for the elimination or waiver of various compliance matters identified by Staff as no longer applicable or superseded by more recent compliance requirements.

Q. Is there anything else included in the Agreement?

A. Yes. The Agreement contains updated Plans of Administration and other schedules related to the provisions in the Settlement Agreement.

SECTION IV - PUBLIC INTEREST

Q. Mr. Abinah, is the Agreement in the public interest?

A. Yes, in Staff's opinion, the Agreement is fair, balanced, and in the public interest.

Q. Would you summarize the reasons that lead Staff to conclude that the Agreement is fair, balanced, and in the public interest?

A. This Agreement results in a settlement package that addresses APS's needs while balancing those needs with terms and conditions that provide customer benefits, such as:

- A $87.25 million non-fuel, non-depreciation revenue requirement increase;
- A reasonable return on equity which will bolster the Company's access to capital markets on better terms including lower interest rates on debt;
- An average 4.54 percent bill impact for residential customers compared to an average 7.96 percent bill impact for residential customers in APS's original application;
- A three-year rate case stay out, in which APS agrees not to raise base rates as a result of any new general rate case filing prior to June 1, 2019;
- Continuation of crisis bill assistance for low income customers with APS to fund an additional $1.25 million annually to assist customers are less than or equal 200 percent of the Federal Poverty Income Guidelines;
- A one-time allocation of $5 million of over collected DSMAC funds to DSM programs for education and outreach to customers;
- A revised buy-through rate for industrial and large commercial customers;

- A refund to customers through the DSMAC of $15 in collected but unspent DSMAC funds to mitigate first year bill impacts;
- A program to expand access to utility owned rooftop solar for low and moderate income Arizonans, Title I Schools, and rural governments;
- More off-peak hours and holidays for time-differentiated rates;
- An experimental pilot technology rate initially available for up to 10,000 customers;
- New updated rate designs with rate options for all customers; Resolution of Solar DG issues for the term of the Agreement;
- Agreement by the Signing Parties to withdraw any appeals of the Commission's Value of Solar Decisions (Decision Nos. 75859 and 75932); and
- Agreement by Signing Parties to refrain from pursuing actions in any forum that are inconsistent with the provisions of the Agreement.

Q. Mr. Abinah, do you believe that the Agreement results in just and reasonable rates for consumers?

A. Yes. In its rate application, customers would have experienced an average _percent bill impact. Under the terms of the Agreement, customers will instead experience an average 4.54 percent bill impact when new rates become effective. Additionally, the Agreement adopts provisions that will assist low-income consumers. Further, the Agreement provides for the refund of $15 million in over collected DSMAC funds that will serve to mitigate the impact of the recommended rate increase.

Q. Please discuss how the Agreement is fair to the utility.

A. The revenue recommended will provide APS with adequate funds to provide reliable and safe service, while at the same time ensuring the financial health of the Company. The LFCR mechanism will also continue to improve APS's revenue stability, which will have a positive impact on its financial profile and credit ratings.

Q. Mr. Abinah, what was Staff's goal when it agreed to be a Signatory to the Agreement?

A. The primary goal of Staff in this matter, as in all rate proceedings before the Commission, is to protect the public interest by recommending rates that are just, fair and reasonable for both the ratepayers, stakeholders and the Company. Staff believes it has accomplished this by reviewing the facts presented and making the appropriate recommendations to the Commission for its consideration. Staff's recommendations will balance the interests of the Company stakeholders and the ratepayers by promoting the Commission's desire to ensure that the Company has the tools and financial health to provide safe, adequate and reliable service, while complying with Commission requirements at just and reasonable rates.

SECTION V – POLICY CONSIDERATIONS

Q. Mr. Abinah, what were the major policy considerations the parties had to deal with in this Docket?

A. I believe there was one major policy consideration that Staff and other Signatories had to address in order to balance the interests of all parties. The growth of the solar energy industry has raised many issues, most of which have been contentious and difficult to resolve. The Commission has addressed some of the issues that have arisen since the approval of the Company's last rate case. For example, the Commission has addressed issues relating to fixed cost shifts in Docket No. E-01345A-13-0248 as well as issues relating to the determination of the cost and value of DG in Docket No. E-00000J-14-0023. A major and important part of the Agreement is the resolution of many of these contentious issues related to DG solar for the term of the Agreement. The DG signatories have also agreed to refrain from pursuing actions in any forum that are inconsistent with the provisions of the Settlement Agreement.

Q. How does the Settlement Agreement address these issues?

A. The Settlement Agreement has several components that address these issues. The Agreement proposes an RCP export rate and plan of administration. Likewise, the Agreement provides for the withdrawal of challenges to the Commission's recent Decisions concerning the value and cost of DG. Staff believes that these provisions, in concert, have tremendous benefit in that they will significantly reduce the time and resources of all parties (including the Commission) that would otherwise be spent on litigation and will instead allow parties to focus their resources on serving consumers and other prospective policy matters.

Q. Is there anything else you would like to add regarding the Agreement?

A. I would like to reiterate that the settlement discussions were transparent, candid, professional and open to all parties in this docket. All parties were allowed to openly express their views and opinions on all issues. I believe the Settlement Agreement is in the public interest.

Q. Does this conclude your Testimony in Support of the Settlement Agreement?

A. Yes.

BEFORE THE ARIZONA CORPORATION COMMISSION

TOM FORESE
Chairman
BOB BURNS
Commissioner
DOUG LITTLE
Commissioner
ANDY TOBIN
Commissioner
BOYD DUNN
Commissioner

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, AND TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN	DOCKET NO. E-01345A-16-0036
IN THE MATTER OF FUEL AND PURCHASED POWER PROCUREMENT AUDITS FOR ARIZONA PUBLIC SERVICE COMPANY	DOCKET NO. E-01345A-16-0123

TESTIMONY

IN SUPPORT OF

THE SETTLEMENT AGREEMENT

OF

RALPH C. SMITH

ON BEHALF OF THE

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

APRIL 3, 2017

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EXECUTIVE SUMMARY
TESTIMONY IN SUPPORT OF SETTLEMENT OF RALPH C. SMITH
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NOS. E-01345A-16-0036 AND E-01345A-16-0123

My testimony in support of the Settlement addresses the following sections of the Settlement Agreement:

- VI. Depreciation/Amortization and Decommissioning
- VII. Fuel and Power Supply Adjustment Provisions
- VIII. Transfer of Items from Adjustment Mechanisms to Base Rates
- IX. Rate Treatment Related to the Installation of Selective Catalytic Reductions at Four Corners Units 4 & 5
- X. Cost Deferral Related to the Ocotillo Modernization Project
- XI. Cost Deferral Related to Changes in Arizona Property Tax Rate
- XVI. Proposed Tax Expense Adjustor Mechanism
- XX. Commercial and Industrial Rate Design
- XXI. E-32L Rate Design
- XXV. Revenue Spread

VI. INTRODUCTION

Q. Please state your name, position, and business address.

A. Ralph C. Smith. I am a Senior Regulatory Consultant at Larkin & Associates, PLLC, 15728 Farmington Road, Livonia, Michigan 48154.

Q. Have you previously submitted testimony in this proceeding?

A. Yes. I previously submitted Direct Testimony on behalf of the Commission's Utilities Division ("Staff") on December 28, 2016, addressing the revenue requirement, rate base, net operating income, and selected other issues, including APS's proposal for new depreciation rates. I also discussed APS's requested cost deferral and step increase for costs associated with installing selective catalytic reduction technology at its Four Corners Power Plant, and APS's requested cost deferral for its Ocotillo Modernization Project.

I also submitted direct testimony on February 3, 2017, addressing rate design, Class Cost of Service Study, separate residential sub-class for NEM energy and NEM demand customers within the residential customer class, revenue allocation, Rate Stabilization Mechanism, Lost Fixed Cost Recovery Mechanism, Environmental Improvement Surcharge, Transmission Cost Adjustment, and other APS-proposed rate changes.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to discuss certain technical areas focusing on the provisions in the Settlement Agreement Sections VI through XI, XVI, XX through XXI, and XXV.

Q. How is your testimony in support of the Settlement Agreement organized?

A. It is organized by subject based on the sections of the Settlement Agreement that I am addressing. My testimony is organized into sections. Section I is this introduction. Sections

VI through XI, XVI, XX through XXI, and XXV each identifies and discusses provisions from those parts of the Settlement Agreement.

VI. DEPRECIATION/AMORTIZATION AND DECOMMISSIONING

Q. Does the Settlement Agreement provide for a reduction in the depreciation rates and resulting annual depreciation expense that were proposed by APS?

A. Yes. Among other things, the Settlement Agreement provides for a reduction in APS's proposed depreciation expense of $20 million per year.

Q. What does the Settlement Agreement state concerning new depreciation rates?

A. The Settlement Agreement at paragraphs 6.1 and 6.2 states as follows:

> 6.1 APS will lower its proposed annual depreciation expense pro forma on APS's as filed SFR C-2 by $20 million per year, resulting in a $61 million increase in depreciation expense (inclusive of the Cholla 2 Regulatory Asset Amortization), by adjusting its proposed lives/net salvage rates for its distribution accounts and by accelerating the amortization of the present excess depreciation reserves for Palo Verde.
>
> 6.2 The annual depreciation expense for the Palo Verde Nuclear Generating Station will be decreased by $21 million.

Q. What is the Cholla 2 regulatory asset?

A. As a result of retiring Unit 2 at the Cholla steam generating plant, APS recorded a regulatory asset relating to the remaining un-depreciated net book value as of the date of the retirement. On April 14, 2015 the Commission approved APS's plan to retire Cholla Unit 2, without expressing any view on the future recoverability of APS's remaining investment in the Unit. APS closed Unit 2 on October 1, 2015. Previously, APS had estimated Cholla Unit 2 service life to end in 2033. APS has been recovering a return on and of the net book value of the unit in base rates, and has sought recovery of the unit's costs over the remaining life of the plant. In the third quarter of 2014, APS reclassified the remaining net book value of Cholla Unit 2 from Property, Plant and Equipment into a regulatory asset account. APS's 2015 FERC Form 1, at page 232.1, shows a balance in account 182.3, Other Regulatory Assets, of approximately $137.432 million as of December 31, 2015, which was being amortized by APS through 2033.

Q. Have the Settling Parties provided for a potential way to accelerate the amortization of the Cholla 2 regulatory asset?

A. Yes. The Settling Parties provided for a potential way to accelerate the amortization of the Cholla 2 regulatory asset. Since the Cholla Unit 2 is no longer providing service after its retirement, providing for a means of accelerating the amortization during the period between resetting APS's base rates is in the public interest. Ideally, if the Cholla 2 regulatory asset amortization is completed by the time APS's base rates are re-established in APS's next rate case, that item would no longer have to be included in the determination of APS's revenue requirement.

Q. How does the Settlement Agreement provide for the Palo Verde depreciation decrease to be applied to facilitate a more rapid amortization of the Cholla 2 regulatory asset?

A. The Settlement Agreement at paragraph 6.3 provides Palo Verde depreciation decrease to be applied to facilitate a more rapid amortization of the Cholla 2 regulatory asset:

> The decrease in Palo Verde depreciation not needed to fund the reduction in revenue requirements described in Section 6.1 above ("Excess Amount") will be offset by a more rapid amortization of the Cholla 2 regulatory asset such that there will be no additional impact on APS's revenue requirement in this case.

Q. If the amortization of the Cholla 2 regulatory asset should be completed prior to APS's next general rate case, how would the Palo Verde depreciation reduction not needed to fund the revenue requirement reduction, i.e., the "excess amount" be applied?

A. As provided for in the Settlement Agreement at paragraph 6.4:

> Should the Cholla 2 regulatory asset become fully amortized prior to APS's next general rate case, the Excess Amount will be used to accelerate the recovery of APS's remaining investment in the Navajo Generating Station.

Q. Why is it relevant and important at this time to consider a means to accelerate the recovery of APS's remaining investment in the Navajo Generating Station?

A. It is relevant and important at this time to consider a means to accelerate the recovery of APS's remaining investment in the Navajo Generating Station[1] because of the uncertainty that exists with respect to how long that plant will be able to continue to operate economically.

Q. What does the Settlement Agreement provide concerning the method under which APS's depreciation rates have been determined?

A. The Settlement Agreement at paragraph 6.5 provides that for purposes of settling this rate case, APS's depreciation rates will be deemed to use the straight-line method, vintage group procedure, and remaining life technique.

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[1] The Navajo station is a 2.25 GW coal-fired generating facility located on the Navajo Indian Reservation near Page, Arizona operated by the Salt River Project (SRP) and co-owned by SRP, APS, the Bureau of Reclamation, NV Energy, and Tucson Electric Power. According to news reports, the owners have been in discussions about the plant's future, creating uncertainty about how long it will be able to continue to operate.

Q. What is the "cost of removal" component of depreciation rates?

A. The Commission's rules at R14-2-102(A)(5) define the "cost of removal" as "the cost of demolishing, dismantling, removing, tearing down, or abandoning of physical assets, including the cost of transportation and handling incidental thereto." Public utility depreciation rates typically include two components (1) for the recovery of the original cost over the service life and (2) for the amount of estimated negative net salvage or cost of removal.

Q. Does the Settlement Agreement provide that, in its next rate case, APS will file alternative calculations of depreciation rates using a different method?

A. Yes. The Settlement Agreement at paragraph 6.6 provides that APS will include calculations using a different method, as alternative calculations for addressing the cost of removal:

> In APS's next rate case, APS will file a depreciation rate study that includes alternative calculations for cost of removal and dismantlement (negative net salvage) using the "FAS 143" discounted net present value method, computed using a discount rate to be agreed upon.

Q. What is the benefit of having APS present such alternative calculations of depreciation rates with its next rate case filing?

A. The cost of removal component of APS's depreciation expense, including dismantlement costs, has been growing substantially and includes a component for estimated future inflation. Having the alternative calculations included with APS's filing will facilitate evaluation by Staff and other parties of alternatives that could help mitigate the impact on customers of depreciation rate increases that are attributable to estimated future inflation.

Q. Has a copy of the agreed upon depreciation rates been included with the Settlement Agreement?

A. Yes. As stated in paragraph 6.7 of the Settlement Agreement, a copy of APS's agreed upon depreciation rates is attached as Appendix A.

Q. Did you perform calculations to affirm that the agreed upon depreciation rates attached in Appendix A to the Settlement Agreement produced the results described above in Settlement Agreement paragraphs 6.1 and 6.2?

A. Yes.

Q. Were the depreciation and amortization rates for all of APS's assets addressed in the Company's Depreciation Rates Study?

A. No. APS had some intangible assets for which depreciation and amortization rates were not addressed in the Company's Depreciation Rates Study.

Q. Please describe Section 6.9 of the Settlement Agreement.

A. Paragraph 6.9 of the Settlement Agreement provides that the APS proposed amortization rates will be used for those items, subject to the Cholla 2 discussion above, as follows:

> 6.9 Subject to the discussion herein of Cholla 2, the Company shall use its proposed amortization rates for regulatory assets and liabilities as well as for other intangibles.

Q. Would it be a good idea for APS to file a listing of all of the amortizations covered in Settlement Agreement paragraph 6.9 in conjunction with its testimony in support of the settlement?

A. Yes. Including a listing of all of the amortizations covered in Settlement Agreement paragraph 6.9 in conjunction with its testimony in support of the settlement, or as an attachment to the Settlement Agreement, will facilitate a look-back by Staff and other parties in APS's next rate case to see exactly what amortizations were being applied to each asset and liability covered by paragraph 6.9.

Q. What annual nuclear decommissioning expense was proposed by APS?

A. APS proposed annual Palo Verde nuclear decommissioning expense of $2.281 million.[2]

Q. Was Staff in agreement with that APS proposal?

A. Yes. Staff did not take issue with the annual amount of Palo Verde nuclear decommissioning expense that APS proposed.

Q. What does the Settlement Agreement provide for annual nuclear decommissioning expense?

A. Paragraph 6.8 of the Settlement Agreement provides that APS's annual nuclear decommissioning expense proposal will be adopted. A copy of the decommissioning contribution schedule is attached as Appendix B.

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[2] See the Direct Testimony of Company witness Elizabeth Blankenship, at page 30.

Q. Why is it important to specify the amount of annual nuclear decommissioning expense that is being recognized in APS's rates?

A. Specifying the amount of annual nuclear decommissioning expense that is being recognized in APS's cost of service is important because of income tax requirements such as tax regulations under Section 1.468A limit the maximum amount of cash payments made (or deemed made) to a nuclear decommissioning fund during any tax year to the cost of service amount applicable to the nuclear decommissioning fund for such tax year or a schedule of ruling amounts, whichever is less. To facilitate compliance with such provisions and to enable the maximum tax deductions for nuclear decommissioning funding, it is a good idea to state the amounts that are being approved for inclusion in the cost of service in a utility's rate case in the regulatory commission's order.

VII. FUEL AND POWER SUPPLY ADJUSTMENT PROVISIONS

Q. Is it customary to reset the base cost of fuel and purchased power in APS's rate cases?

A. Yes. Typically, the base cost of fuel and purchased power is updated in APS's rate cases based on current information and recent forecasts of fuel and purchased power costs and related information. Fluctuations in actual fuel and purchased power cost occurring between rate cases are then addressed via the operation of APS's Power Supply Adjustor ("PSA") mechanism. APS's current PSA recovers (or credits) for charges in the covered fuel and purchased power costs above (or below) the base cost of fuel and purchased power.

Q. What did the Settlement Agreement's state concerning the Fuel and Power Supply Adjustment provision?

A. The Settlement Agreement at paragraph 7.1 states that:

> The base fuel rate shall be lowered from $0.032071 per kWh as set in the Decision No. 73183 to $0.030168 per kWh. This change shall take effect on

> the effective date of the new rates contained in this Agreement, in accordance with the Plan of Administration for the Power Supply Adjustor ("PSA") to be approved in this case.

Q. Is that base cost of fuel rate reasonable and appropriate?

A. Yes. It is appropriate to update the base cost of fuel rate for updated information, which is reflected, based on the agreement of the Signing Parties, in the $0.030168 per kWh rate listed in paragraph 7.1 as noted above. As also noted above, fluctuations above or below the base cost of fuel are addressed in APS's PSA. Thus, prudently incurred costs for fuel and purchased power are recovered via a combination of base rates and the PSA rate.

Q. Does the Settlement Agreement provide that APS will be permitted to recover certain additional types of costs via the PSA?

A. Yes. Paragraphs 7.2 and 7.3 provide the APS shall be permitted to include certain specified chemical costs that are incurred in the generation process and costs for third-party storage expenses, as follows:

> 7.2 APS shall be permitted to include chemical costs for lime, ammonia and sulfur that are incurred in the generation process in the PSA.
> 7.3 APS shall be permitted to include third-party storage expenses in the PSA provided that APS files for approval to include any third-party storage contract with the Commission 90 days before it becomes effective.

Q. Are those provisions in the public interest?

A. Yes.

Q. How does the Settlement Agreement address the timing of APS's PSA filings?

A. Paragraph 7.4 of the Settlement Agreement provides as follows:

> The September 30 Preliminary Annual PSA Rate filing and the December 31 Final Annual PSA Rate calculation filing will be consolidated into one annual

> reset filing that will occur annually on or before November 30. Unless the Commission otherwise acts on the APS calculation by February 1, the PSA rate proposed by APS will go into effect with the first billing cycle in February.

Q. What is the reason for including that provision?

A. This provision is intended to consolidate the APS PSA filings, and to facilitate the review of APS's PSA filing and the implementation of new PSA rates.

Q. Has a copy of the updated PSA Plan of Administration been included with the Settlement Agreement?

A. Yes. Paragraph 7.5 provides that the PSA Plan of Administration shall be amended as necessary to reflect the terms of this Agreement and shall be approved concurrent with the approval of this Agreement. The revised PSA Plan of Administration is attached as Appendix C to the Settlement Agreement.

VIII. TRANSFER OF ITEMS FROM ADJUSTMENT MECHANISMS TO BASE RATES

Q. What did the Settlement Agreement state concerning the transfer of items from adjustment mechanisms into base rates?

A. The Settlement Agreement at paragraphs 8.1 through 8.3 states as follows:

> 8.1 The Signing Parties agree that certain revenue requirements collected through the Renewable Energy Adjustor Clause ("REAC"), DSMAC Lost Fixed Cost Recovery ("LFCR"), Transmission Cost Adjustor ("TCA"), Environmental Impact Surcharge ("EIS"), Four Corners Rate Rider ("FCRR"), and the System Benefits Charge ("SBC") adjustment mechanisms shall be transferred to base rates and those adjustor rates will be zeroed out or reduced, as proposed by APS herein.
>
> 8.2 Adjustor transfers agreed to herein shall include the portion of transmission revenue requirements that was collected in the test year for the TCA, the portion of the lost fixed costs that was collected in the test year for the LFCR; the portion of environmental compliance revenue requirements that was collected in the test year for the EIS; an increase in the portion of

energy efficiency expense to be collected in base rates from the DSMAC; the revenue requirement of Arizona Sun related renewable generation, the Schools and Governments Program and the Community Power Project will be transferred from the REAC into base rates; the portion of APS's acquisition of Southern California Edison's share of Four Corners currently collected in the Four Corners Rate Rider; and the portion of the System Benefits reduction that went into effect January 1, 2016 to reflect Palo Verde Unit 2 having been fully funded in the nuclear decommissioning trust. The specific amounts in each adjustor to be transferred to base rates pursuant to this Section are identified in Appendix D. The amounts transferred will be calculated using Staff's revenue conversion factor.

8.3 On the effective date of the new rates contained in this Agreement, the REAC, DSMAC, LFCR, TCA, EIS, FCRR and SBC rates shall be reduced to reflect the removal of the amounts identified in Appendix D.

Q. Did you verify the calculation of the amounts listed in Appendix D?

A. Yes. As noted in paragraph 8.2 of the Settlement Agreement: "The amounts transferred will be calculated using Staff's revenue conversion factor." As shown in the following table, the amounts listed in Appendix D to the Settlement agreement were recalculated from amounts contained in Staff's Direct Testimony filing (specifically at Attachment RCS-2, Schedule A, page 3) by applying the Staff's adjusted Gross Revenue Conversion Factor ("GRCF"):

Arizona Public Service Company
Summary of Adjustor Mechanisms Transferred to Base Rates

Test Year Ended December 31, 2015
(Thousands of Dollars)

Line No.	Description	ACC Jurisdictional Amount Per APS (A)	Staff Adjustment	ACC Jurisdictional Amount Per Staff (B)	Staff GRCF C	APS GRCF D	Test Amount For ¶8 Recalculate E = BxC/D	Settlement Agreement Adjusted F	Difference G = E-F
	From Staff Direct Filing, Attachment RCS-2, Schedule A, page 3				SETTLEMENT AMOUNT VERIFICATION CALCS				
1	Transmission Cost Adjustor (TCA)	$ 128,602		$ 128,602	1.6178	1.6155	$ 128,785	$ 128,785	$ 0
2	Lost Fixed Cost Recovery (LFCR)	$ 45,988		$ 45,988	1.6178	1.6155	$ 46,053	$ 46,054	$ (1)
3	Environmental Improvement Surcharge (EIS)	$ 2,456		$ 2,456	1.6178	1.6155	$ 2,459	$ 2,459	$ 0
4	Demand Side Management Adjustment Clause (DSMAC)	$ 9,979		$ 9,979	1.6178	1.6155	$ 9,993	$ 9,993	$ 0
5	Renewable Energy Adjustment Clause (REAC)	$ 37,543		$ 37,543	1.6178	1.6155	$ 37,596	$ 37,596	$ 0
6	Four Corners Rate Rider	$ 57,588		$ 57,588	1.6178	1.6155	$ 57,670	$ 57,670	$ (0)
7	Palo Verde Unit 2	$ (14,604)		$ (14,604)			$ (14,604)	$ (14,604)	$ -
9	Total of Adjustor Mechanisms Transferred to Base Rates	$ 267,551	$ -	$ 267,551			$ 267,954	$ 267,953	$ 1
									rounding

Notes and Source
Col. A: Amounts discussed in the Direct Testimony of Company witness Leland R. Snook

GRCFs are from Staff Direct Testimony Filing, Ralph Smith, Attachment RCS-2, Schedule A-1 (and Schedule A, line 6)

IX. RATE TREATMENT RELATED TO THE INSTALLATION OF SELECTIVE CATALYTIC REDUCTION EQUIPMENT AT FOUR CORNERS UNITS 4 & 5

Q. What environmental controls are being installed at the Four Corners Generating Facility?

A. To comply with federal environmental standards, APS is installing selective catalytic reduction equipment, or SCRs, at its Four Corners Generating Facility. This equipment will significantly reduce fossil emissions of nitrogen oxides, while permitting APS to continue supplying its customers with inexpensive fossil base load generation. APS must install these SCRs in time to meet upcoming compliance deadlines. APS indicated that the first SCR will be installed on Four Corners Unit 5 and placed in service in late 2017 and the second SCR will be installed on Four Corners Unit 4 and placed in service in Spring 2018. APS has estimated that the direct construction cost for the SCRs to be approximately $400 million.

Q. What did the Settlement Agreement state concerning the rate treatment related to the installation of selective catalytic reductions at Four Corners Units 4 & 5?

A. The Settlement Agreement at paragraphs 9.1 through 9.4 provides for a deferral and step increase approach, including some enhanced reporting requirements and safeguards that Staff views as an improvement to APS's original proposal, as follows:

> 9.1 The parties agree that this Docket shall remain open for the sole purpose of allowing APS to file a request that its rates be adjusted no later than January 1, 2019 to reflect the proposed addition of Selective Catalytic Reduction ("SCR") equipment at Four Corners, as requested in APS's application in this Docket.
>
> 9.2 APS shall be authorized by the Commission to defer for possible later recovery through rates, all non-fuel costs (as defined herein to include all O&M, property taxes, depreciation, and a return at APS's embedded cost of debt in this proceeding) of owning, operating and maintaining the Selective Catalytic Reduction environmental controls at the Four Corners Power Plant from the date such controls go into service until the inclusion of such costs into rates. Nothing in this paragraph shall be construed in any way to limit this

> Commission's authority to review the entirety of the project and to make any disallowances thereof due to imprudence, errors or inappropriate application of the requirements of this Decision. The interest component of the SCR deferral will be set at APS's embedded cost of debt established in this Agreement.
>
> 9.3 Any filing seeking a rate adjustment pursuant to Section 9.1 shall include the following schedules: (1) the most current APS balance sheet at the time of filing; (2) the most current APS income statement at the time of filing; (3) an earnings schedule that demonstrates that the operating income resulting from the rate adjustment does not result in a return on rate base in excess of that authorized by this Agreement in the period after the rate adjustment becomes effective; (4) a revenue requirement calculation, including the amortization of any deferred costs; (5) an adjusted rate base schedule; and (6) a typical bill analysis under present and filed rates. The Signing Parties agree to use good faith efforts to process this rate adjustment request such that any resulting rate adjustment becomes effective no later than January 1, 2019, pursuant to Section 9.1.
>
> 9.4 The Signing Parties shall not present any issues in the rate adjustment proceeding other than those specifically described in this Section.

Q. Is a deferral and step increase approach for the Four Corners SCR costs reasonable and in the public interest?

A. Yes, I believe so, particularly as stated in the Settlement Agreement provisions cited above, and considering that the alternative to such ratemaking treatment would be for APS to immediately file another base rate case.

Q. What is provided for in Settlement Agreement paragraph 9.5?

A. Settlement Agreement paragraph 9.5 provides as follows:

> Section 9 is agreed to without prejudice to any position taken by a Signing Party in any other pending proceeding, including ASBA/AASBO v. ACC, 1 CA-CC-15-0001.

Q. Why was that provision included?

A. Settlement Agreement paragraph 9.5 was included to recognize that the agreement on the special deferral and step-increase rate treatment provided for in the Settlement Agreement is limited to this APS rate case and thus would not compromise any party's position in other pending proceedings, including the cited case.

X. COST DEFERRAL RELATED TO THE OCOTILLO MODERNIZATION PROJECT

Q. What is the Ocotillo Modernization Project?

A. APS is constructing and will place into service a modernized Ocotillo Generating Facility. The Ocotillo Modernization Project ("OMP") involves retiring 220 MWs of existing steam generation and replacing them with 510 MW of modern natural-gas-fired combustion turbine generation. New Ocotillo Units 6 and 7 will go into service in the fall of 2018, and Units 3, 4, and 5 will go into service in the Spring of 2019. APS estimates that the total direct construction cost of the OMP will be approximately $500 million.

Q. What does the Settlement Agreement state concerning the cost deferral related to the Ocotillo Modernization Project?

A. The Settlement Agreement at paragraphs 10.1 through 10.3 states as follows:

> 10.1 APS will be authorized to defer for possible later recovery through rates, all non-fuel costs (as defined herein to include all O&M, property taxes, depreciation, and a return at APS's embedded cost of debt in this proceeding) of owning, operating, and maintaining the Ocotillo Modernization Project ("OMP") and retiring the existing steam generation at Ocotillo. Nothing in this paragraph shall be construed in any way to limit the Commission's authority to review the entirety of the project and to make any disallowances thereof due to imprudence, errors or inappropriate application of the requirements of this Decision. The interest component of the Ocotillo deferral will be set at APS's embedded cost of debt established in this Agreement.

> 10.2 The entire OMP will be in service before the rate effective date of APS's next general rate case, and the entire OMP investment will be addressed and resolved in that proceeding.
>
> 10.3 This agreement does not address the prudence of the OMP, and a deferral of the OMP costs does not guarantee recovery of those costs. Consideration of OMP in APS's next general rate case does not create any precedent, guarantee, or certainty regarding the consideration or treatment of post-test year plant.

Q. Are these provisions in the public interest?

A. Yes. These provisions allow APS to defer costs related to the OMP, and require that the entire OMP will be in-service before the rate effective date of APS's next general rate case, and the entire OMP investment will be addressed and resolved in that proceeding. The interest component of the deferral is set at APS's embedded cost of debt established in this agreement. Thus, APS's ratepayers will not be responsible for providing APS with an equity return on the OMP deferral prior to its being recognized in rates. It is also specifically stated that consideration of the OMP in APS's next general rate case does not create any precedent, guarantee, or certainty regarding the consideration or treatment of post-test year plant. Moreover, nothing in the settlement paragraphs concerning the OMP deferrals shall be construed in any way to limit the Commission's authority to review the entirety of the project and to make any disallowances thereof due to imprudence, errors, or inappropriate application of the requirements of this Decision.

Q. Will it be necessary to review in detail, in APS's next rate case, the OMP costs that have been deferred by APS?

A. Yes, it will, and the ability to review such costs and make any disallowances thereof due to imprudence, errors, or inappropriate application of the requirements of this Decision is kept intact by the above-quoted provisions of the Settlement Agreement.

XI. COST DEFERRAL RELATED TO CHANGES IN ARIZONA PROPERTY TAX RATE

Q. What does the Settlement Agreement state concerning the cost deferral related to changes in Arizona property tax rate?

A. The Settlement Agreement at paragraphs 11.1 through 11.5 states as follows:

> 11.1 APS shall be allowed to defer for future recovery (or credit to customers) the Arizona property tax expense above or below the test year caused by Changes to the applicable Arizona composite property tax rate.
>
> 11.2 The property tax deferral will not accrue interest during the deferral period, unless it is negative, in which case, it will accrue interest in favor of APS's customers at APS's short term debt rate.
>
> 11.3 Beginning with the effective date of the Commission decision resulting from APS's next general rate case, any final property tax rate deferral that has a positive balance will be recovered from customers over 10 years, with a return at APS's short term debt rate, also with a return on any unrefunded negative balance at the same short term debt rate.
>
> 11.4 The Signing Parties reserve the right to review APS's property tax deferrals in APS 's next general rate case for reasonableness and prudence.
>
> 11.5 Prior to the next APS general rate case, APS will meet and confer with Staff, RUCO and other stakeholders regarding the appropriate ratemaking treatment for the two year lag on payment of property taxes for post-test year plant.

Q. Is this provision in the public interest?

A. As an integral part of the overall Settlement Agreement, yes it is. Unlike the context of APS's original proposal, the Settlement Agreement includes a provision addressing the timing of APS's next rate case.[3] The property tax deferral provision enhances APS's ability to extend the period between rate cases and is thus related to the rate case stability provision of the Settlement Agreement. It is also noted that the property tax deferral will not accrue interest,

[3] See, e.g., Section II, Rate Case Stability Provision.

unless it is negative, in which case, it would accrue interest in favor of APS's ratepayers at APS's short-term debt rate.

XVI. PROPOSED T.E.A.M. ADJUSTOR

Q. Is it possible that there could be major changes to federal income taxes before APS's next base rate case?

A. Yes. It is possible that there could be major changes to federal income taxes before APS's next base rate case. Congress and the current administration may be proposing major changes to federal income tax laws and major tax reform. It is unclear exactly what form that will take, but items that have been identified include possible reductions in corporate income tax rates.

Q. Does the Settlement Agreement take into consideration that federal income taxes could be changed?

A. Yes. The Settlement Agreement includes an adjustor provision that would provide a method of flowing to customers the impact of reductions in federal corporate income tax rates, net of other potential federal income tax changes that could occur before new base rates are set in a subsequent APS rate case. This is reflected in the Tax Expense Adjustor Mechanism (TEAM).

Q. Please discuss how the TEAM Adjustor addresses significant changes in federal income taxes, should they affect APS before rates are re-established in APS's next base rate case.

A. As described in paragraph 16.1 of the Settlement Agreement, the TEAM Adjustor recognizes the possibility that significant Federal income tax reform legislation could be enacted and become effective prior to the conclusion of APS's next general rate case. It provides that if such legislation materially impacts the Company's annual revenue requirements, APS will create a rate adjustment mechanism to enable the pass-through of income tax effects to its customers.

Q. How would the TEAM Adjustor measure the impact of significant federal income tax changes on APS?

A. As described in paragraph 16.2 of the Settlement Agreement, the TEAM Adjustor would measure the impact on APS's income taxes by focusing on changes in the following three components:

> 1) The Federal Income Tax Rate (currently 35%) applied to the Company's Adjusted 2015 Test Year;
>
> 2) The annual amortization of any resulting excess deferred income tax regulatory account compared to the Company's Adjusted 2015 Test Year, and;
>
> 3) Permanent income tax adjustments (such as interest expense and/or property tax expense deductibility) compared to those taken in the Company's Adjusted 2015 Test Year.

Q. How often would a TEAM adjustment occur, if significant federal income tax changes are determined to affect APS?

A. The TEAM Adjustor rate will be computed on a prospective basis each year based on the jurisdictional retail income tax change as compared to the income tax expense used to set rates in this proceeding combined with the Company's projection of jurisdictional retail sales for the coming year. The rate will be filed on December first and will become effective with the first billing cycle in March of each year.

Q. How would the TEAM Adjustor be assessed to APS's customers?

A. The adjustment will be assessed to each customer as an equal per kWh charge.

Q. Is there a balancing account feature associated with the TEAM Adjustor?

A. Yes. The adjustor mechanism will include a balancing account such that any under- or over-collected balance will be recovered or refunded in the following year.

Q. Would interest be accrued on the balances?

A. Yes. The Settlement Agreement provides at paragraph 16(b)(vi) that each year's under- or over-collected balance will accrue interest at the Company's applicable cost of short-term debt.

Q. When would the TEAM Adjustor terminate?

A. As indicated in paragraph 16.4 of the Settlement Agreement, the TEAM will terminate with the effective date of APS's next general rate case.

Q. Has a Plan of Administration for the TEAM Adjustor been included with the Settlement Agreement?

A. Yes, as indicated in paragraph 16.4 of the Settlement Agreement, the Plan of Administration for the TEAM is attached as Appendix E.

Q. Is having a provision to address potential significant federal income tax changes on APS before APS's base rates are re-set in APS's next rate case in the public interest?

A. Yes, it is. Income taxes are a significant component of APS's base rate revenue requirement. Changes in federal income tax rates could therefore significantly affect APS's revenue requirement. Having a provision to address potential significant federal income tax changes on APS before APS's base rates are re-set in APS's next rate case helps assure that such impacts would be accounted for and could benefit APS's customers in the event that some of the potential changes, such as a reduction in corporate income tax rates, flow through to the benefit of APS's customers. Thus, having such a provision included in the Settlement Agreement is in the public interest.

XX. COMMERCIAL AND INDUSTRIAL RATE DESIGN

Q. Under the Settlement Agreement, will APS continue to offer extra small General Service customers a traditional two-part rate option?

A. Yes. As provided in paragraph 20.1 of the Settlement Agreement, APS will continue to offer extra small General Service customers a traditional two-part rate option. Specifically, APS's General Service XS non-demand rate is adopted and is detailed in Appendix G to the Settlement Agreement.

Q. How are extra small General Service customers defined in conjunction with that rate?

A. Extra small General Service customers are defined as having a monthly demand of 20 kW or less.

Q. What does the Settlement Agreement provide for an aggregation feature and for an Extra High Load Factor Rate?

A. Paragraph 20.2 of the Settlement Agreement states that APS's Aggregation feature and Extra High Load Factor Rate as proposed by the Company are adopted.

Q. Are copies of those rate schedules included with the Settlement Agreement?

A. Yes. Copies of those Schedules are attached to the Settlement Agreement in Appendix I.

Q. Did APS propose new rate discount provisions associated with encouraging economic development in its service territory?

A. Yes. APS proposed Service Schedule 9, which is intended to support commercial and industrial economic development in the APS service territory.

Q. Does the Settlement Agreement provide for a new Economic Development rate discount?

A. Yes. Paragraph 20.3 of the Settlement Agreement states that the provisions for Economic Development Service, Schedule 9, is approved as modified by Staff and is attached as Appendix J.

Q. What is the public interest benefit of having a special rate provision for economic development?

A. The public interest benefit is to support commercial and industrial economic development in the APS service territory that may not otherwise occur without the availability of the specifically targeted rate discounts for new qualifying new or expanding customers who meet the specified criteria.

Q. Were Staff's concerns incorporated into the Economic Development Service, Schedule 9, provisions?

A. Yes. Staff's concerns have been incorporated into the Economic Development Service, Schedule 9, provisions that are attached to the Settlement Agreement in Appendix J.

Q. Does the Settlement Agreement keep intact the current net metering structure for nonresidential customers?

A. Yes. Paragraph 20.4 of the Settlement Agreement provides that there will be no change to the current net metering structure for nonresidential solar customers until addressed in a future Value of Solar or other proceeding.

Q. What is a "ratchet" in the context of utility rate design?

A. A "ratchet" feature of utility rate design generally provides that once a specified threshold has been reached, such as a certain level of demand in a specified period, that level becomes the new basis for billing. As it relates to APS, the Company uses a ratchet when determining the appropriate demand billing determinate to use pursuant to assessing large customers' monthly demand charges.

Q. What are the reasons for including a ratchet provision in designing utility rates?

A. Demand ratchets are generally included in electric utility rates to reduce the risks to the utility of serving certain types of customers who have potentially large swings in demand during the year. Typically, ratchets are imposed upon large industrial customers who are often connected to the system at the transmission level. A large amount of investment in transmission lines and other facilities may be dedicated solely to these customers; consequently, a significant decline in their demand could severely diminish the utility's ability to recover the fixed costs of these facilities. The imposition of a demand ratchet would allow the utility to earn a more stable revenue stream even when the customer's demand falls to low levels.

Q. What advantages are typically cited for including a demand ratchet in designing utility rates?

A. A number of advantages may be cited for having demand ratchets. First, they can help to stabilize the utility's revenues and minimize the risk of serving large customers. From the system viewpoint, a ratchet provision can encourage the industrial customers to increase their annual load factor, which often promotes favorable load characteristics. Moreover, ratchets can improve the equity of a utility's rate design. For example, a transformer may be dedicated to the use of one customer who has a large load for only two months and is inoperative during the rest of the year. If some kind of demand ratchet is not imposed, the fixed costs of that transformer will tend to be recovered through other users during the months that the customer is off the system. A ratchet provides a mechanism for the utility to recover the costs of the transformer from the customer who is responsible for those costs.

Q. What are some disadvantages of utility rates that incorporate demand ratchets?

A. A demand ratchet could encourage excessive energy consumption. A high demand ratchet places significant emphasis on a customer's demand during just one period of the year. Once the ratchet level is hit, the customer would have a lower incentive to conserve during all the other hours of the year, particularly if the energy rate is low. For example, if a 100% demand ratchet was imposed, a customer would be billed on the basis of his maximum peak kW demand for the year, no matter how low their actual demand for the current month might be. As long as the customer stays below that annual peak, the day-to-day consumption decisions will not have an effect upon the demand portion of the energy bill. Except during the brief period when the demand is near its annual peak, the customer will not be encouraged to conserve energy. This is particularly true if a large part of the customer's bill is collected through the demand ratchet, and the kWH rate is minimal.

Demand ratchets may also be perceived as being inequitable. It may seem unfair to a customer to be required to pay for kWs that they did not actually use during the current month, especially if the customer's low level of demand during other months frees up capacity which can be used by other customers.

Q. What specifically had APS proposed for ratchet provisions in its C&I rate design?

A. APS has an existing demand ratchet for its LGS customers, which include General Service rate classifications E-32L and E-32 TOU L. Specifically, APS assesses LGS customers' billing demand based on the greatest of the following three criteria: (1) the average kW supplied during the 15-minute period (or other period as specified by an individual customer contract) of maximum use during the month as determined from readings of the Company's meters or in accordance with the Company's Service Schedule 8; (2) 80% of the highest kW measured during the six summer billing months (May-October) of the twelve months ending with the current month; or (3) the minimum kW specified in the agreement for service or individual contract. Of these three criteria, the second one represents APS's demand ratchet. The Company maintained this existing demand ratchet in its proposed LGS rates.

Q. Does the Settlement Agreement fully resolve concerns about having a ratchet feature in APS's proposed C&I rate design?

A. No, it does not. At paragraph 20.5, the Settlement Agreement provides that the Signing Parties agree that issues related to the non-ratchet rate design alternative for Commercial and Industrial customers remain unresolved by this Agreement, and the Signing Parties agree they may present their respective positions in the hearing scheduled in this proceeding.

Q. Does the Settlement Agreement provide for a revised on-peak period for most of APS's general service customers?

A. Yes. At paragraph 20.6, the Settlement Agreement provides that the on-peak period will be 3:00 pm - 8:00 pm weekdays for XS through E32-L, but will remain unchanged for E-35.

Q. What is the current on-peak period for those rates?

A. The current on-peak period for those rates, which are Time-of-Use rates is 11 am to 9 pm Monday through Friday.

Q. What is the basis for updating the on-peak period?

A. The update to the on-peak period is based on APS's load research.

Q. Is it appropriate and in the public interest to update the on-peak provisions of a utility's tariffs when the update is supported by the utility's load research?

A. Yes. Updating the peak period stated in the tariffs, when based on the utility's load research, facilitates the development of rates that are associated with cost causation.

XII. E-32L RATE DESIGN

Q. What is the E-32L Rate Class?

A. Rate E-32 L is a large general service rate class that is available to non-residential customers with monthly loads of 401 kW or greater.

Q. What does the Settlement Agreement provide for rate redesign for the E-32L class?

A. The Settlement Agreement at paragraph 21.1 provides that APS agrees to redesign E-32L in a revenue neutral manner to recover an additional amount of $1.36 per kW in the unbundled generation charges.

Q. What is meant by the term "in a revenue neutral manner"?

A. The term "in a revenue neutral manner" means that the recovery of the unbundled generation charges will not cause the total revenue to be higher or lower.

XXV. REVENUE SPREAD

Q. What does the Settlement Agreement provide for the revenue spread?

A Paragraph 25.1 provides that for the revised revenue requirement, APS will keep the same revenue spread between Residential and General Service classes.

Q. What about within the General Service class?

A. Because General Service Extra Small and Small customers originally had a near zero net bill impact, the reduction agreed to in the Settlement Agreement will be spread to all other General Service customers proportionally to the original revenue spread.

Q. Is the revenue spread shown in one of the appendices to the Settlement Agreement?

A. Yes. Appendix L shows a summary of the revenue spread/targets.

Q. Is there anything else you would like to add regarding the Settlement Agreement?

A. Yes. It should be recognized that the electric utility industry is undergoing a period of significant changes. This APS rate case presents complex and challenging issues. While the Settlement Agreement is not unanimous and some intervenors have not signed, the fact that 29 parties with widely diverse interests have signed and have indicated that they believe that the Agreement balances APS's rate increase with benefits for customers and is in the public interest should carry considerable weight.

Q. Does this conclude your Direct Testimony in support of the Settlement Agreement?

A. Yes, it does.